HALEY BARBOUR
GOVERNOR

STATE OF MISSISSIPPI
OFFICE OF THE GOVERNOR

November 17, 2008

To the Members of the Mississippi Legislature:

Pursuant to Miss. Code § 27-103-139, I transmit to you herewith my Executive Budget Recommendation for Fiscal Year 2010.

This is my sixth budget recommendation, but it is my first during a period of declining state revenue. Indeed, because of the severe shortfall, earlier this month I was required to make budget cuts of some $42 million for the current fiscal year, FY09.

It is my belief additional revenue shortfalls will occur before the end of this fiscal year, and, despite the possibility of additional collections of corporate income taxes delayed by federal hurricane disaster assistance efforts, more cuts may be needed during FY09.

This Executive Budget Recommendation is based on the FY10 revenue estimate approved by the Joint Legislative Budget Committee on November 11, 2008. This budget is balanced, according to that revenue estimate; however, I consider it likely the FY10 revenue estimate will be lowered by the time of the adoption of the sine die version in March 2009. Nevertheless, the revenue component of this budget is consistent with the current revenue estimate, as required by state law.

Both the national and the world economies are in recession, whether technically or not. Beginning with the housing collapse that followed the sub-prime crisis and greatly escalated by $4.00 gasoline this past spring, the healthy job increases and per capita income gains of the preceding three years gave way to an abrupt slowdown in residential construction and layoffs in homebuilding and in our automotive sector. Since late summer the downturn has spread across more of the general economy.

Additionally, some of our counter-cyclical sectors, like energy and defense contracting, appear less healthy than a few months ago. Our gaming industry has seen a decreased handle, with accompanying reductions in our gaming tax revenue. The collapse of commodity prices will not only adversely affect our farmers and their incomes, but will also reduce state oil and gas severance tax collections. Indeed, virtually every indicator points to decreasing state revenue.

Considering the contraction of many other nations' economies, there is every reason to expect this recession will not be as brief or shallow as were those of 1990-91 and 2000-01; rather it is prudent to anticipate and prepare for a longer, deeper economic retrenchment, such as that which began in the late 1970's and ended in late 1982.

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While I am praying for the best, we should prepare for the worst. This budget anticipates two to four years of recession or slow growth, and uses the Rainy Day Fund (technically the Working Cash Stabilization Fund) accordingly.

Prudent, responsible budget policy practiced by the state since 2004 gives us maximum capacity to deal with decreasing revenue, as the Rainy Day Fund was filled to its statutory amount, giving us a balance of $378 million at the end of FY08.

This is a vast improvement over the balance my first year in office when the Rainy Day Fund had a balance of $22 million, of which $15 million was pledged to the Ayers settlement.

As you will recall, in FY04 (the last budget adopted before I became Governor) the state had a budget shortfall in excess of $700 million; that is, the state spent over $700 million more on recurring expenses than the state received in recurring revenue. It took half my first term to dig out of that hole, and I never want to see the state in a hole like that again.

We must avoid that fate by a combination of prudent spending reductions; appropriate revenue increases; and responsible use of only a portion of the Rainy Day Fund, keeping a reasonable balance for the needs in future years. Manageable spending cuts in FY10, coupled with conservative use of Rainy Day Funds, mean an ample Rain Day Fund balance to cushion against larger cuts in the following years.

The primary spending reductions in my FY10 budget generally coincide with the FY09 cuts imposed last week. For the most part departments and agencies that are reducing expenditures this year by two percent would be reduced an additional two percent in FY10.

Back to back two percent annual spending reductions are not severe; in the Musgrove Administration a number of departments and agencies were cut five percent in one year. Universities were cut seven percent, and state funding for community colleges was cut sixteen percent!

Still, a four percent cut over two years requires department and agency heads be given maximum flexibility to make the savings in ways that allow them to provide the most effective service to the state and its constituents. I ask the Legislature to join me in granting management the discretion to achieve the needed efficiencies.

Further, most departments and agencies have had healthy budget increases in recent years. All three levels of education – K-12, universities and community colleges – received record funding levels in my first four years, and all received record appropriations for FY09. Most other department and agencies are budgeted at very high spending levels, too.

The total of the combined cuts for FY10 is $87,141,124 as compared to actual FY09 appropriations.

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As with the FY09 executive spending reductions some programs, like the MAEP program, are exempt or held harmless from the FY10 recommended reductions. A list is attached, and the lines are also noted in the budget spreadsheet.

Some programs, such as MAEP, National Board Certified Teacher funding and High School Redesign are held harmless as a matter of policy. Others, like the Ayers settlement, the Olivia Y foster care settlement, and similar litigation, are exempt because of court decisions. Debt service is exempt as a matter of law and contract.

Every department, including the Governor’s office, is asked to make some savings, and there is no part of state government that cannot reduce spending without adversely affecting performance . . . none.

Pursuant to the recommendation of the Tax Study Commission I created earlier this year, this budget recommends increases in tobacco taxes. The twenty-four cents (.24) per pack increase in the current cigarette tax would put Mississippi’s cigarette tax at forty-two cents (.42) per pack, essentially the same as the average of the tax now levied by Alabama, Arkansas, Louisiana, Mississippi and Tennessee.

This budget requires non-participating cigarette manufacturers (NPMs) to pay an additional tax of forty-three cents (.43) per pack. The purpose is to require them to pay in the same amount as those cigarette companies that pay Mississippi more than $100 million annually under the tobacco settlement reached in the nineties.

Further, there is an increase in revenue from smokeless tobacco by converting it to a volume-based tax like cigarettes.

These tobacco tax increases would generate some $80 million in additional revenue in FY10, and, if passed early in the Regular Session, about $13 million this fiscal year.

Tobacco tax increases are driven by health care policy, not budget policy, and I would welcome offsetting tax cuts. Indeed, this term I will propose tax cuts in greater amounts than these increases, as I’m committed to a net tax cut as proper budget policy.

The combined savings on expenditures and tax increases on tobacco yield $167 million to make up part of the differential with revenue. To make up part of the remaining difference, I recommend use of $84 million from the Rainy Day Fund, leaving a projected balance of over $292 million to alleviate future revenue shortfalls.

This budget may well have to be adjusted in FY10 by further reducing spending and by limited, appropriate further Rainy Day Fund use. Good policy dictates if revenue drops further below current estimates that conservative use of Rainy Day Funds is even more important, for continuing revenue shortfalls indicate the recession will be deeper and the need for sufficient Rainy Day Fund balances in coming years will be even greater.

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Among the budgets not cut in this budget is that of the Division of Medicaid. During my first term the number of Mississippians on Medicaid decreased from well more than 700,000 to fewer than 600,000. Part of the reason for the decrease was Medicare Part D, which led to the removal of most PLAD beneficiaries, as Part D gave them pharmaceutical coverage they had previously received from Medicaid. A larger number came off the rolls as net employment in the State increased by more than 60,000. That many more people working means tens of thousands become ineligible for Medicaid, for the right reason.

Conversely, rising unemployment during this international recession will mean more people will rely on Medicaid, and the Division of Medicaid team will have to work hard to manage spending to stay within the proposed budgeted level, which represents an increase in state funds of $41.3 million for FY10.

Since the summer of 2005 there has been a $90 million structural deficiency in Medicaid funding. The cause is a 2005 change in federal rules as to the eligibility of $90 million of payments (taxes) in the form of Intergovernmental Transfers (IGTs) by certain Mississippi hospitals as state match for federal disproportionate share hospital (DSH) payments.

As a result of Katrina, for most of three years federal disaster assistance payments for emergency health care were used to cover the shortfall. This year, after the Legislature failed to pass a bill to replace the $90 million, (the Senate passed SB 2013 to cover the gap, but the House passed no fair, permanent or sustainable plan) the federal agency that runs Medicaid, CMS, agreed it owed the State some $92 million, which it paid and which is being used to bridge the shortfall for FY09.

A fair, permanent, sustainable source of the $90 million is required for FY 10 and beyond, or Medicaid spending must be cut by $375 million (i.e., $90 million in state funds and $285 million in federal funds).

From 1993 to 2005 Mississippi hospitals gladly paid the $90 million in taxes (IGT) in order to maximize DSH payments to hospitals. Indeed, in 1993 it was the Mississippi Hospital Association that asked the Legislature to impose the tax, as it knew there was no way other than a provider fee to bring in the available federal funds.

And in 2001 the Mississippi Hospital Association asked the Legislature to impose another tax or provider fee on its members, a Gross Revenue Assessment, to maximize the amount of funds hospitals receive from another federal Medicaid program called UPL, or upper payment limit.

Nursing homes, like hospitals, pay into the provider fee system to maximize the federal funds available for Mississippi's Medicaid program. In fact, fully thirty percent (30%) or $1.2 billion of the state's Medicaid spending is generated by the provider fee system.

Last year, hospitals, which receive $6 in Medicaid payments for every $1 they would pay in if the $90 million tax is restored, first supported, then opposed restoration of the tax. In the Special Session the

Senate passed SB 2013, which restored the $90 million in hospital taxes according to a formula devised by the Mississippi Hospital Association, by a vote of 41-7.

While Special Funds, such as the provider fees paid by hospitals and nursing homes, are not reflected in this budget, let me reiterate that I will ask the Legislature to reinstate this $90 million in hospital taxes during the Regular Session. Otherwise, Medicaid spending must be cut $375 million; or the $90 million Medicaid deficit created by giving hospitals this enormous tax cut, despite their getting the benefit of the disbursements and reimbursements previously generated by the provider fee, would have to be made up by spending cuts in other departments or agencies. For example, if tobacco taxes were used to fill the $90 million Medicaid deficit, then there would be an $80 million hole in the General Fund budget, to be made up by cuts to education, law enforcement, etc. Or Rainy Day Funds in the amount of another $90 million would have to be spent, with all the damage that would do to needed spending in future years.

There is no doubt the best course by far is to reinstate the $90 million in taxes hospitals paid gladly for thirteen years in order to get an additional $285 million in federal Medicaid payments. That will be my course.

A primary recommendation of the Tax Study Commission was to reduce the amount of taxes owed the state but not collected. To that end, we must improve our technology infrastructure. My budget provides a $15 million investment in FY10 for information technology improvements for the State Tax Commission to enhance its capacity to collect the taxes owed the State. This would be followed by another $15 million investment the next year. These investments in IT would begin paying off in FY11 and begin generating net revenue in FY12.

Over time the State needs to make additional, large investments to replace antiquated technology platforms that deliver services such as accounting, payroll and data storage, just to name a few.

Another of the very few new spending proposals in this budget is to fund the Mississippi Health Insurance Exchange. Our State has an unacceptably high rate of underinsured citizens, and the largest category is some 135,000 Mississippians who work for small businesses that do not offer employer-sponsored health insurance.

Last year I proposed this program as a way to make health insurance less expensive and easier to administer for small businesses and its employees. The bill passed the Senate 52-0, but the House failed to consider it. I will offer it again this year, and this budget contains $1.5 million for start-up funding.

This budget is conservative, prudent and realistic: It maximizes funding for our priorities while recognizing every department, even our highest priority – education – can make some savings.

This budget is balanced not only between revenue and expenditures; it is also balanced in using Rainy Day Funds and tobacco taxes along with initial spending cuts to achieve a truly balanced budget. I recognize and ask others to recognize that any further reductions to predicted revenue will primarily be

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made up by reductions in spending. Hopefully, we won't have to cross that bridge in March or April when the Legislature enacts the actual FY10 budget and appropriations.

Sincerely,

Haley Barbour

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